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SUMMARY

The Commission's proposal in the Further Notice to exclude cable systems with penetration levels below 30% in calculating the competitive benchmark is flatly illegal. The Commission lacks the statutory authority to eliminate the low penetration systems from the "effective competition" categories defined by the 1992 Cable Act. Further, the record does not support further rate reductions. As the expert papers attached to these comments demonstrate, the FCC's methodology is flawed and any further rate reductions would be arbitrary and capricious and without record support.

As explained in the attachments, the assumptions made and conclusions reached by Professor Hazlett, CFA, and NATOA are plainly inaccurate and do not support the exclusion of low penetration systems from the data selection process. On the contrary, they support the points demonstrated in TWE's initial comments that the entire sampling process and methodology would have to be reevaluated before the Commission could use its analysis as a rational basis for regulating cable rates.

Agency rules that are promulgated on the basis of flawed assumptions or methodology, or upon inaccurate data, will fail appellate scrutiny. Similarly, courts will not hesitate to reverse agency decisions when they are based on a sample that is too small or when the sample does not fairly represent the industry. Excluding the rates of low penetration systems from the competitive benchmark will severely reduce the sample size of effectively competitive systems. Basing the competitive

benchmark on such a small number of systems in order to govern the rates of cable systems nationwide cannot be sustained in logic or in law.

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
Rate Regulation	)	
Further Notice of Proposed Rulemaking	)	

REPLY COMMENTS OF TIME WARNER ENTERTAINMENT COMPANY, L.P.

Time Warner Entertainment Company, L.P. ("TWE"), by its attorneys, hereby files its reply comments in the Further Notice of Proposed Rulemaking in MM Docket No. 92-266, Cable Rate Regulation.[1] The Further Notice seeks comment on whether the Commission should issue new benchmarks that exclude the rates of cable systems with less than 30% penetration. Excluding such systems, according to the Commission's analysis, would yield a 28% "competitive differential." TWE strongly opposes the proposal of the Further Notice to require further rate reductions. The attachments to these replies by Dr. Daniel Kelley of Hatfield Associates Inc. and National Economic Research

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[1] See Implementation of Rate Regulation Sections of the Cable Television Consumer Protection and Competition Act of 1992, Report and Order and Further Notice of Proposed Rulemaking, MM Dkt. No. 92-266 (rel. May 3, 1993) ("Rate Order" or "Further Notice").

Associates, Inc. ("NERA"),[2] along with other evidence submitted in the record, demonstrate that there is no sound basis in econometrics or law to order further rate reductions for cable systems subject to rate regulation.

I. AS A MATTER OF LAW, THE BELOW 30 SYSTEMS CANNOT BE ELIMINATED WHOLESALE.

The overwhelming force of the record demonstrates unequivocally that the FCC lacks the legal authority to disregard Congress' judgment that low penetration systems be classified as "effectively competitive."[3] Supporters of the 28% reduction proposal offer little else than "Congress didn't really mean it" when it legislated Section 623(l)(A).

As TWE and others showed, however, the legislative definitions were crafted precisely in response to Congressional dissatisfaction with the Commission's earlier efforts.[4] The recognition that low penetration systems face pricing constraints that result in the ability to earn only competitive returns can

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[2] Daniel Kelley, "Economic Issues Raised by the Further Notice: Evidence from Low Penetration Systems," July 2, 1993; Lewis J. Perl, Linda McLaughlin, and Jonathan Falk, National Economic Research Associates, Inc., "Econometric Issues Raised by the Further Notice," July 1, 1993.

[3] See, e.g., Comments filed on June 17, 1993 by the Antenna Television Association, Inc., Coalition of Small System Operators, Discovery Communications, Inc., Continental Cablevision, Inc., the Joint Parties (which include Cablevision Industries Corp., Comcast Cable Communications Inc., Cox Cable Communications, Jones Intercable, Inc., Marcus Cable Company, L.P., Southwest Missouri Cable TV, Inc., and Vista Communications, Inc.), National Cable Television Association, Inc., and Viacom International, Inc.

[4] See TWE Comments at 4-6.

be found in numerous predecessor bills, and ultimately survived the various changes and debates that surrounded the Cable Act's passage. See, e.g., S.833, 101st Cong., 1st Sess. (1989). There is simply no basis in law for ignoring the plain, unambiguous dictates of the legislature.

II. THE RECORD DOES NOT SUPPORT FURTHER RATE REDUCTIONS.

Even if the Commission had been granted the discretion to exclude the below 30 systems, the record will not support the additional rate reductions based on the methodology employed. In reviewing agency actions, courts will examine the adequacy of an agency's test data as well as the reasonableness and reliability of the methodology employed. See, e.g., National Lime Ass'n v. EPA, 627 F.2d 416 (D.C. Cir. 1980). Promulgation of rules based upon flawed methodology or inadequate test data "def[ies] the Administrative Procedure Act's mandate against action that is 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.'" Id. at 430; 5 U.S.C. § 706. Given the methodological flaws proven to exist in the Commission's econometric effort, as discussed below and in the attached papers, further rate reductions cannot be sustained.

The record documents the multiple technical and [illegible] explained in TWE's initial comments that "the econometric evidence in support of the 10 percent reduction is weak."[6] Some of the problems resulting from the use of the weak methodology, as Dr. Kelley reiterates here, could have been mitigated if separate benchmarks were established for basic and cable programming services. But because of the Commission's decision to apply a tier neutral approach, the "legitimacy of the entire econometric exercise is in doubt[.]"[7]

Evidence provided by both Dr. Kelley and National Economic Research Associates, Inc. in TWE's initial comments, as well as substantial analyses submitted by others,[8] demonstrate that refinements to the Commission's approach for establishing the competitive benchmark would support lower, not larger, rate

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TWE, in its Petition for Reconsideration, filed June 21, 1993, demonstrated that the Commission's methodology is so flawed that it cannot support even the 10% differential. Id. at 2-4. The same problems [illegible] reductions.[9] Adoption of the Further Notice's proposal on the basis of the current record is thus simply not sustainable.[10] See, e.g., City of Brookings Municipal Telephone Co. v. FCC, 822 F.2d 1153, 1171 (D.C. Cir. 1987).

In contrast to the extensive quantitative and qualitative evidence submitted by TWE and others, very limited argument and no persuasive evidence was submitted in favor of the Further Notice's proposal. Upon examination, the Joint Comments of Bell Atlantic, GTE and NYNEX, the Comments filed by the Consumer Federation of America ("CFA"), and the Comments of NATOA do not support further rate reductions. On the contrary, those efforts actually confirm the conclusion that Dr. Kelley and NERA reached in TWE's initial comments: the Commission's benchmark approach fails to account for significant variables, is too broadly averaged to be reliable, and finally, elimination of the below 30% systems would yield far too small a number to form a legitimate basis for further rate reductions.[11]

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[9] Daniel Kelley, "Economic Issues Raised by the Further Notice," June 17, 1993, at 6-8; Lewis J. Perl, Linda McLaughlin, and Jonathan Falk, "Econometric Analysis of the FCC's Proposed Competitive Benchmarks," June 16, 1993, at 2-4.

[10] For example, if the Commission intends to exclude the rates of low penetration systems from its sample, then it should similarly identify and remove from the sample the rates of overbuild firms that are pricing below competitive levels. See Daniel Kelley, "Economic Issues Raised by the Further Notice," June 17, 1993, at 5-6.

[11] See Daniel Kelley, "Economic Issues Raised by the Further Notice," June 17, 1993; Lewis J. Perl, Linda McLaughlin, and Jonathan Falk, "Econometric Analysis of the FCC's Proposed Competitive Benchmarks," June 16, 1993.

A. The Below 30 Systems Do Not Reflect Rates that Are "Too High"

As Professor Hazlett, CFA, and NATOA implicitly concede, low penetration is linked to many demand and cost factors. For example, NATOA claims that low penetration systems contain more small-size, high-cost systems than do the groups of overbuild or municipally-owned systems. CFA argues that there are many cost causative characteristics inherent in low penetration systems that are not found in other competitive and noncompetitive systems. The Commission's econometric model does not adequately take into account these important variables. Professor Hazlett, CFA, and NATOA would correct this problem by removing those cable systems with less than 30% penetration. However, the solution is not to "throw away" the low penetration systems, but rather to rectify the model's failings.

As Dr. Kelley and NERA explain, it is erroneous to conclude that these systems should be deleted from the competitive benchmark. If there are important variables that affect the prices of cable services, these variables should be included in the regression analysis. As Dr. Kelley states, the Commission's model should be refined "so that the influence of important variables on both the low penetration and random sample [illegible] model that adequately reflects the effect of these variables on all systems.[13]

Moreover, Professor Hazlett, CFA, and NATOA's approach to summarily exclude low penetration systems from the competitive benchmark is contrary to law. See, e.g., National Lime Ass'n v. EPA, 627 F.2d at 433, 443 (D.C. Cir. 1980) (an agency in promulgating rules has a duty to identify specific, relevant and irrelevant variable conditions and ensure that they are taken account of in analyzing test data). Courts will also reject comparisons that prejudicially omit, as the Commission proposes to do here, the "outlying" data in favor of more preferable observations. See, e.g., Major Coat Co. v. United States, 543 F.2d 97, 114 (Ct. Cl. 1976), reh'g denied, 549 F.2d 196 (1977) (price comparisons in excessive profits case held to be fundamentally skewed where only average and median profit industry figures dominated record). The Commission's analysis leading to a 28% rate reduction flatly contradicts these principles. The law requires what common sense dictates: a reliable model should reflect those characteristics that are relevant to a cable system's rates, such as cost and demand elasticity.

Professor Hazlett based some of his conclusions upon a telephone survey performed on behalf of the three telephone companies. The report of the survey is grossly inadequate in explaining what questions were specifically asked, the identity and qualifications of the survey questioners and respondents, how

[13] Id. at 4 (footnote omitted).

various responses were treated with respect to follow-up questions, how the questioners determined that the appropriate respondent was the party reached, etc. The remarkably casual nature of the survey, and the undisclosed biases that very likely inhere in it, make the survey virtually useless as any kind of competent evidence useful to these proceedings.

Based upon this highly suspect survey, Professor Hazlett states that the limited presence of competition from multichannel video distributors in the below 30% systems means that the rates are necessarily "too high." He incorrectly concludes that competitive results occur only if alternative multichannel video programmers are present.

There are numerous problems with this conclusion. First, Congress specifically included low penetration systems in the effectively competitive definitions <u>in addition to</u> those facing multichannel competitors. In doing this, Congress implicitly recognized that the absence of multichannel alternatives did not necessarily mean the rates for cable services would be "too high." Moreover, this legislative judgment is soundly grounded in economic principles. As explained below, other competitive constraints may exist, and/or low penetration may reflect low demand.

Dr. Kelley explains that "as a matter of economic theory, actual direct competitors are not required to generate a competitive result."[14] Pricing constraints flow from both the

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[14] Kelley at 6.

presence of multi-channel competition, the availability of substitutes, and as a function of local demand. For example, where a franchise area receives adequate over-the-air reception of numerous signals, one would expect that cable systems in that area would have lower penetration levels. Similarly, particular demographics of specific areas identified by Professor Hazlett, such as income levels and age of consumers, can have a direct, constraining effect on the prices the local cable operator can charge.

Professor Hazlett's current claim that low penetration is not evidence of effective competition but rather due to high prices is also inconsistent with his earlier work that found no correlation between price and penetration. <u>See</u> Thomas Hazlett, <u>The Demand to Regulate Franchise Monopoly: Evidence from CATV Rate Deregulation in California</u>, 29 Economic Inquiry 275, 286-287. Another of his articles explains that "low penetration rates are not synonymous with market power. Even in a competitive market, high costs could raise prices and lower penetration, or a thin demand (due to exogenous factors) could raise per-unit costs and thereby drive prices up." <u>See</u> Thomas Hazlett, <u>Competition vs. Franchise Monopoly in Cable Television</u>, 4 Contemporary Policy Issues 80, 85 (1986).[15]

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[15] Additionally, Professor Hazlett's point that the Act's definition of penetration "cannot be reconciled with the search

Furthermore, there is no indication in the record that the rates of low penetration systems are "high" because these systems provide poor service to subscribers, as Professor Hazlett suggests. The telcos' survey, as informal and unreliable as it is, in fact indicates that customer dissatisfaction was barely mentioned as a reason for not subscribing to cable.[16]

But even if it were plausible that poor service quality or other factors not accounted for in the Commission's model results in higher rates for low penetration systems, it would be arbitrary and capricious for the Commission to remove these systems from the data selection process without analyzing the rates of overbuild or municipal firms that may be lower than true competitive levels. Several parties, including TWE, observed in their initial comments that the rates of overbuild systems may be "too low" because of short term price wars. Indeed, as Mr. Shew proved, prices in overbuild areas are lower where such competition has been short-lived (less than four-to-five years).[17] Likewise, the rates of municipally-owned cable systems

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Professor Hazlett is correct that the Commission's definition skews the sampling process by inflating the number of cable systems included in the category of low penetration systems, it certainly skews the number of overbuilds in the opposite direction.

[16] Kelley at 4.

[17] Declaration of William Shew, Director of Economic Studies, Arthur Andersen Economic Consulting, June 17, 1993, at 12.

may be artificially low due to subsidies that they receive.[18] In short, there is no rational basis upon which to simply eliminate the "problem" of complexity by pretending it is isn't there.

B. The Benchmark Model is Too Broadly Averaged to be Used to Order Further Rate Reductions.

The record also supports TWE's conclusion in its initial comments that the Commission's model fails to account for the effects of system size. Three different studies showed that at various breakpoints, (e.g., above and below 10,000 subscribers, below 5000 subscribers, and five other size classes) the competitive differential varies dramatically across system sizes.[19] Each of these econometric studies shows that there is a fundamental and fatal defect in the Commission's regression analysis. Proceeding in the face of this evidence would mean that large sectors of the cable industry would be inappropriately, arbitrarily and unlawfully ordered to reduce rates that are in fact reasonable.

The papers proffered by CFA and Professor Hazlett only exacerbate this problem. As the attached NERA paper explains,

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[18] See, e.g., Comments of the Coalition of Small System Operators, at 3-4; Comments of the National Television Cable Association, Inc., at 11; Comments of the Community Antenna Television Association, Inc., at 5.

[19] Stanley M. Besen and John R. Woodbury, "An Analysis of the FCC's Cable Television Benchmark Rates, June 17, 1993, at 21-26, 32-34; Lewis J. Perl, Linda Mclaughlin, and Jonathan Falk, "Econometric Analysis of the FCC's Proposed Competitive Benchmarks," June 16, 1993, at 7-8; Petition for Reconsideration

both of those parties use the difference in average prices to draw certain conclusions about the competitive effects of the different groups surveyed.[20] In so doing, they have utterly ignored significant differences, resulting in "averages which are simply misleading."[21]

Given the problems with averaging which already demonstrably exist with the FCC's regression analysis,[22] there is no basis for ordering further rate reductions. Further erroneous averaging offered by CFA and the telcos cannot compensate for the errors in the benchmark analysis.

The requirement that an agency engage in reasoned decisionmaking mandates "that assumptions be stated, that process be revealed, that the rejection of alternative theories or abandonment of alternative courses of action be explained and that the rationale for the ultimate decision be set forth." National Lime Ass'n v. EPA, 627 F.2d at 453 (D.C. Cir. 1980) (footnotes omitted). There is ample evidence in the record demonstrating that refinements to the Commission's approach to

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[20] As Dr. Kelley explains, "Throughout the affidavit, Professor Hazlett confuses simple averages with competitive benchmarks." Kelley at 3, n.3. This confusion similarly leads Professor Hazlett to erroneously characterize the rates of low penetration systems as higher than those for the random sample, a misstatement that even CFA recognizes. Data Analysis of Consumer Federation of America, filed March 8, 1993, at 6.

[21] NERA at 3.

[22] The problems of averaging in the Commission's methodology are fully described by NERA in TWE's Petition for Reconsideration of the Rate Order, filed June 21, 1993, Lewis J. Perl, Linda McLaughlin and Jonathan Falk, "Econometric Assessment of the FCC's Benchmark Model," June 18, 1993.

establishing the benchmark would correct at least some of the shortfalls identified to date. The FCC itself has admitted that there are errors in its quantitative effort.[23] Ordering further rate reductions without considering required refinements is grounds for reversal of agency action. City of Brookings Municipal Telephone Company v. FCC, 822 F.2d 1153, 1168 (D.C. Cir. 1987): "This court has been particularly reluctant to blink at an agency's ignoring ostensibly reasonable alternatives where it admits, as the Commission has here, that the choice embraced suffers from noteworthy flaws." Id. at 1169.

C. Eliminating The Below 30 Systems Would Reduce the Sample to an Unusable Size.

Numerous experts submitted studies showing that the elimination of the below 30 systems reduces the number of "effectively competitive" observations to such a small number that the entire effort loses any credibility. Especially in light of the fact that some of the "observations" are merely duplicate responses for the very same systems, the actual number of systems that would form the basis for regulating the cable industry nationwide would be reduced to 46.

The problem with sample size is in fact appreciated by CFA. As they state, "the data make clear that the very small number of the [overbuild] systems render it impossible for the Commission

[23] Rate Order at Appendix E, ¶¶ 16, 31, and note 11.

to rely on survey data to concoct a quasi-cost approach...."[24] To exclude low penetration systems from an already too small database would in effect remove a whole class of effectively competitive systems from the competitive benchmark analysis. The paltry 46 "competitive" responses (and only 42 separate cable systems) that would remain are simply too small a number on which to regulate an industry consisting of 33,000 cable community units. Courts will reject statistical analysis if the sample used is too small, and this one is certainly too small. See Package Shop Inc. v. Anheuser-Busch, Inc., 675 F. Supp. 894, 951-952 (D. N.J. 1987) (comparison of prices in "competitive" and "noncompetitive" markets in antitrust case rejected due to unjustifiably small sample); Permian Basin Rate Cases, 390 U.S. 747, 769 (1968), reh'g denied, 392 U.S. 917 (1968) ("it has been thought to be sufficient if the agency has before it representative evidence, ample in quality to measure with appropriate precision the financial and other requirements of the pertinent parties"); National Lime Ass'n v. EPA, 627 F.2d at 432 (D.C. Cir. 1980).

[24] Data Analysis of Consumer Federation of America, filed March 8, 1993, at 2.

CONCLUSION

TWE respectfully urges the Commission not to order further rate reductions. The Commission lacks the legal authority to exclude the below 30 systems as a category of effective competition systems. Moreover, additional reductions in rates based on the Commission's current methodology and underlying assumptions would be arbitrary and capricious and contrary to accepted econometric principles. Accordingly, the Commission should reject the proposal of the Further Notice.

Respectfully submitted,

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ECONOMIC ISSUES RAISED BY THE FURTHER NOTICE: EVIDENCE FROM LOW PENETRATION SYSTEMS

Prepared for

Time Warner Entertainment Company, L.P.

By

Daniel Kelley

Hatfield Associates, Inc.

July 2, 1993

ECONOMIC ISSUES RAISED BY THE FURTHER NOTICE:
EVIDENCE FROM LOW PENETRATION SYSTEMS[1]

In an affidavit filed in support of the Joint Comments of Bell Atlantic, GTE, and the NYNEX Telephone Companies (Joint Comments), Professor Thomas Hazlett concludes that low penetration systems must be excluded from the benchmark rate calculations. Professor Hazlett's analysis does not support this conclusion. If anything, Professor Hazlett's findings support the broad conclusion that the benchmark model used by the Federal Communications Commission cannot support further rate reductions.

Stated simply, Professor Hazlett's main point is that variables not included in the Commission's analysis have a significant impact on cable system prices. Professor Hazlett identified, through a telephone survey, several variables that tend to increase the rates of low penetration systems. He then concludes that the Commission should not rely on evidence provided by these systems to establish the competitive benchmark rates. Professor Hazlett ignores the fact that a more detailed investigation of the factors influencing the rates of the both the overbuild and the random sample firms is likely to lead to the discovery of other important explanatory variables.

The solution is not, as Professor Hazlett suggests, to ignore the low penetration systems. The solution is to refine the Commission model so that the influence of important variables on both the low penetration and random sample rates can be captured. *Ad hoc* changes to the Congressionally defined set of competitive firms are not appropriate. Any

[1] I submitted a statement in this proceeding with the Comments of Time Warner Entertainment Company, L.P. See "Economic Issues Raised by the Further Notice," June 17, 1993.

changes to the Commission's model must be systematic, taking account of all of the technical problems noted in this proceeding.

The analysis provided by Professor Hazlett does help to illustrate some problems inherent in the Commission's general cable rate regulation methodology. Econometric comparisons of "competitive" and "non-competitive" systems may simply be too problematic to provide adequate benchmarks for cable programming services. Therefore, as explained below, the next logical step for the Commission is to reconsider its decision to employ tier neutral regulation.[2]

Section I shows that the evidence gathered by Professor Hazlett does not support the conclusions he reaches. Section II explains why some problems with the Commission benchmarks can be addressed by eliminating tier neutrality.

I. PROFESSOR HAZLETT'S ANALYSIS DOES NOT SUPPORT HIS CONCLUSIONS

Two related problems with Professor Hazlett's analysis are described below. First, it is inappropriate to conclude that low penetration firms are not charging competitive rates simply because those rates may, on average, be high. Second, it is inappropriate to assume that a multi-channel competitor must be present in order for competitive results to be achieved.

A. Variables affecting prices in low penetration systems

[2] This issue is discussed in detail in my submission with the initial Further Notice Comments, *supra,* note 1, and in "Economics of Cable Rate Regulation," January 25, 1993.

Professor Hazlett concludes that systems have low penetration because they have high prices. There is no adequate basis for this conclusion.[3] Both penetration and price will be the result of a large number of factors. Professor Hazlett argues that penetration will be low in systems that have low income, elderly, and seasonally transient populations. These characteristics suggest that demand will be elastic. Cost characteristics (such as density or technology) will also account for differences. In other words, penetration is an endogenous variable.

The Commission's econometric model is simply not sufficiently detailed to adequately reflect these differences. The model fails to account for any number of cost and demand factors that may affect both penetration and price. The variable for the number of households will not adequately capture the effects of low demand. There can be systems with low numbers of households and high penetration and systems with higher numbers of households and low penetration. In other words, as suggested in the NERA paper submitted earlier, the Commission's model is misspecified.[4]

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[3] Throughout the affidavit, Professor Hazlett confuses simple averages with competitive benchmarks. See, e.g., p. 7, where he claims that increasing the number of low penetration firms could lead to benchmark rates higher than existing rates. The benchmark rates are not constructed from simple averages of the rates for the random sample of firms and the rates for the statutorily defined competitive firms. The benchmark rates are based on statistical comparisons of system characteristics. Thus, the rates for a firm could be above the average for the random sample but below the benchmark if its system characteristics lead to a prediction of higher rates than it actually charges. The problem Professor Hazlett notes would be due to a misspecification of the model, not to use of low penetration firms to compute benchmarks.

[4] See "Econometric Analysis of the FCC's Proposed Competitive Benchmarks," June 16, 1993.

Eliminating the low penetration systems from the competitive sample is not the solution to this problem. The effect of demographic factors on rates does not disappear when penetration exceeds 30 percent. Systems in the random sample are likely affected by the demographic variables that Professor Hazlett has identified. Therefore, the solution is to develop a model that adequately reflects the effect of these variables on all systems.[5]

Professor Hazlett has identified one source of misspecification of the Commission's econometric model. Many other problems have been discovered.[6] It would obviously not be appropriate to fix just one problem, without identifying and repairing the others as well.

There is an alternate hypothesis that might be consistent with Professor Hazlett's desire to eliminate low penetration systems from the competitive category. If these firms have low penetration because they provide poor service, then they are unlikely to be generating competitive performance. Professor Hazlett claims that "...local officials in Type A [low penetration] communities repeatedly cite customer dissatisfaction as an explanation of low subscribership." (p. 11) However, the survey results do not support this conclusion. Of the 79 communities surveyed, customer dissatisfaction was mentioned in only eight cases, or

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[5] Lack of statistical significance is not a basis for excluding important variables from the model. See *id.*

[6] Several Petitions for Reconsideration of the Order filed on June 22, 1993 provide strong evidence that the model is misspecified. See Lewis J. Perl, Linda McLaughlin and Jonathan Falk, "Econometric Assessment of the FCC's Benchmark Model," James N. Dertouzos and Steven S. Wildman, "Regulatory Benchmarks for Cable Rates: A Review of the FCC Methodology," Economists Inc, "The Effect of 'Competition' on Rates Differs for Large and Small Cable Systems." See also Stanley M. Besen and John R. Woodbury , Charles River Associates, "An Analysis of the FCC's Cable Television Benchmark Rates," filed June 17, 1993, in this proceeding.

about 10 percent of the time.[7] By contrast, low income was cited 43 times, an elderly population 28 times, and seasonality 13 times. Given the survey, there is no assurance that poor service quality is the dominant factor explaining low penetration.

One would not expect to see a large number of firms providing such poor service that their penetration rates are far below the industry average. Such firms are leaving money on the table by driving customers away. There is an active market for cable firms. Better managed firms can be expected to seek out and acquire franchises that provide service well below industry norms because those franchises present profit opportunities.[8]

Even if it were true that poor customer service is a pervasive problem, it would be arbitrary to eliminate these systems from consideration without a careful analysis of the overbuild firms to eliminate rates that are artificially low because they are not in a competitive equilibrium. For example, municipal overbuild firms may be subsidized.[9] Piecemeal changes to the Commission's benchmark methodology are not appropriate. Global changes recognizing all of the significant shortcomings of the Commission's model are required.

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[7] We have no way of knowing whether the manner in which the survey was conducted may have biased responses.

[8] See, for example, Henry G. Manne, "Mergers and the Market for Corporate Control," Journal of Political Economy (April 1965), pp. 110-120.

[9] See Malarkey-Taylor Associates, Inc., "Economic Analysis of Municipal Overbuild Cable System in Paragould, Arkansas," June 21, 1993. Submitted with the Petition for Reconsideration of National Cable Television Association.